Supreme Court, U.S.
FILED
FEB 11 1992
OFFICE OF THE CLERK

No. 91-1135

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1991

NEWARK MORNING LEDGER,
as Successor to The Herald Company,
Petitioner.

VS.

UNITED STATES OF AMERICA,
Respondent.

MEMORANDUM OF AMICUS CURIAE MAGAZINE PUBLISHERS OF AMERICA, INC. IN SUPPORT OF PETITIONER

JAMES L. MALONE III*
GEORGE W. BENSON
McDERMOTT, WILL & EMERY
227 W. Monroe Street
Chicago, Illinois 60606
(312) 372-3000
**Counsel of Record*
For Amicus Curiae

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MEMORANDUM OF AMICUS CURIAE MAGAZINE PUBLISHERS OF AMERICA, INC. IN SUPPORT OF PETITIONER

Amicus Magazine Publishers of America, Inc. (MPA) is a national trade association incorporated under the laws of the State of New York. It submits this brief in support of the petitioner's petition for a writ of certiorari.[1] MPA's membership includes 235 publishing firms that publish 1,193 consumer interest magazines. MPA members' publications include mass-circulation weeklies, monthly home and fashion magazines, journals of opinion, non-profit publications, and a wide variety of special interest publications. These publications are the leading magazines in an industry which sells approximately 9,000,000,000 subscription copies and 2,400,000,000 single issue newsstand copies per year.

[1] Written consent of the parties has been filed with the Clerk of the Supreme Court pursuant to Rule 37.

MPA members regularly acquire, collect and maintain extensive subscription and other demographic information regarding the subscribers to their publications.

In the 1980s a number of MPA members purchased magazines in asset or asset-equivalent transactions involving billions of dollars. The transactions were planned and executed with the expectation, based upon decided cases and respondent's own rulings and acquiescences, that the amounts expended for the acquired subscribers would be amortizable over the limited life of those subscribers under IRC § 167. Contrary to its earlier pronouncements, respondent now challenges the fundamental economic and tax assumptions upon which both buyers and sellers conceived and executed their transactions.

SUMMARY OF ARGUMENT

The Third Circuit misperceived the applicable precedent and created a conflict among the circuits. It substituted a restricted definition of goodwill found in the case law for the descriptions of depreciable intangible assets and non-depreciable (residual) goodwill found in the Treasury Regulations. While it relied upon *Houston Chronicle Publishing Co. v. United States*, 481 F.2d 1240 (5th Cir. 1973), cert. denied, 414 U.S. 1129 (1974), it ignored the Fifth Circuit's rejection of "the establishment of a *per se* monolithic 'mass asset' theory that would amalgamate all subscription lists with goodwill." *Id.* at 1253.

Though the Third Circuit relied upon numerous cases for its definition of goodwill (App. at 23a-25a), it ignored the fact that in a number of these cases the court also determined that the taxpayer had acquired a separate and distinct, depreciable intangible asset. Additionally, the Third Circuit also failed to cite or rely upon the latest cases from the circuits which have considered the same issue.

Finally, the District Court has provided in its "galaxy of customers" description an appropriate "bright line" test to distinguish between separate and distinct, depreciable customer-based intangible assets and non-depreciable goodwill.

For these reasons, the Court should grant certiorari and reverse the decision of the Third Circuit.

ARGUMENT

I

THE THIRD CIRCUIT HAS MISPERCEIVED THE APPLICABLE LAW AND TREASURY REGULATIONS AND HAS CREATED A CONFLICT AMONG THE CIRCUITS

The decision of the Third Circuit is in conflict with decisions in many of the Circuits.[2] It is the result of a fundamentally flawed analysis of the applicable case law and statutory and regulatory provisions.

Goodwill is an elusive concept. Not properly defined, it has meant many different things to courts, taxpayers and the Internal Revenue Service. Properly defined and considered in the context of a long-standing Treasury Regulation,[3] however, non-deprecia-

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[2] The most recent relevant Circuit Court opinions are: *Panichi v. United States*, 834 F.2d 300 (2nd Cir. 1987) (purchase of a customer list only, and not an entire business); *Laird v. United States*, 556 F.2d 1224 (5th Cir. 1977); *Donrey, Inc. v. United States*, 809 F.2d 534 (8th Cir. 1987) (acquisition of a business, including customer based intangible assets; holding that in *General Television, Inc. v. United States*, 548 F.2d 1148 (8th Cir. 1979), it held "[e]ntitlement to a depreciation deduction for an intangible asset is a question of fact." 809 F.2d at 536-37); *Commission v. Seaboard Finance Co.*, 367 F.2d 646 (9th Cir. 1966); *Citizens & Southern Co. v. Commissioner* 919 F.2d 1492 (11th Cir. 1990) (core deposit accounts acquired in the acquisition of a bank are depreciable); *Richard S. Miller & Sons, Inc.* 537 F.2d 446 (Ct.Cl. 1976); see also *Super Food Services, Inc. v. United States*, 416 F.2d 1236 (7th Cir. 1969), (separate intangible assets found to exist in purchase of grocery store business; this taxpayer victory was not mentioned in *Decker v. Commissioner*, 864 F.2d 51 (7th Cir. 1988)).

[3] Treas. Reg § 1.167(a)-3 provides:

> If an intangible asset is known from experience or other factors to be of use in the business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy, such an intangible asset may be the subject of a

ble (residual) goodwill is easily distinguished from depreciable intangible assets. The Fifth, Seventh, Eighth, Ninth, Eleventh and Federal Circuits and the Tax Court have determined that depreciable intangible assets can be segregated from non-depreciable goodwill in the purchase of an on-going business.[4]

It is essential in resolving the conflict between the circuits that the Court focus upon the *segregation* of "intangible assets . . . [having] a limited life, the length of which can be estimated with reasonable accuracy," from non-depreciable (residual) goodwill. This, after all, is the scheme which respondent itself has adopted in its recent regulations.[5]

The confusion about what the term "goodwill" has meant in various tax circumstances was summarized at length in *Meredith Broadcasting Co. v. United States,* 405 F.2d 1214, 1224-25, (Ct.Cl. 1968); and repeated in *Richard S. Miller & Sons, Inc. v. United States, supra,* 537 F.2d 446, 450-452, (Ct.Cl. 1976). Significantly, in both cases the Court of Claims held that if the useful life of an intangible asset could be shown to be of limited duration, and hence a "wasting asset," it would be considered to be distinct from "goodwill" and, therefore, depreciable. *Id.*

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depreciation allowance. Examples are patents and copyrights. An intangible asset, the useful life of which is not limited, is not subject to the allowance merely because, in the unsupported opinion of a taxpayer, the intangible asset has a limited useful life. No deduction for depreciation is allowable with respect to goodwill.

[4] *Laird v. United States,* (5th Cir.); *Super Food Services, Inc. v. United States,* (7th Cir.); *Donrey, Inc. v. United States,* (8th Cir.); *Commissioner v. Seaboard Finance Co.,* (9th Cir.); *Citizens & Southern Co. v. Commissioner,* (11th Cir); *Richard S. Miller & Sons, Inc. v. United States,* (Ct. Cl.) *supra;* and *IT & S of Iowa, Inc. v. Commissioner,* 97 T.C. No. 34 (Nov. 12, 1991).

[5] See IRC § 338 and § 1060 and Treas. Reg. § 1.338(b)-2T(b)(2) and § 1.1060-1(d)(2), where intangible assets are designated as "Class III" assets and goodwill is designated as a residual "Class IV" asset. That Congress and the Treasury would make this distinction undermines the Third Circuit's reliance on the "separate and distinct" language from the case law." *Infra,* pp. 5-7.

The Third Circuit quoted from *Miller* (App. at 20a), but ignored the distinction between depreciable intangible assets and non-depreciable goodwill found in the Treasury Regulation. It held that petitioner had not satisfied its burden of demonstrating that its paid subscribers were *"separate and distinct from goodwill."* (App. at 29a.)

The importance which the Third Circuit gave to the "separate and distinct" language was misplaced. This language is not found in the applicable statute[6] or Treasury Regulation.[7] While the "separate and distinct" language has its precedent in early case law, its application there suggests that even in 1926, the Eighth Circuit correctly distinguished non-depreciable goodwill from depreciable intangible assets which may be sold "separate and apart" from an established, on-going business.[8] Customer lists are such a "separate and distinct" asset.[9] Nowhere in the current precedent is there any support for the Third Circuit's conclusion

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[6] Section 167(a) provides:

(a) General Rule—there shall be allowed as a depreciation deduction a resonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolesence) (1) of property used in the trade or business, or (2) of property held for the production of income.

[7] Treas. Reg. 1.167(a)-3, at footnote. 2, *supra.*

[8] *Red Wing Malting Co. v. Willcuts,* 15 F.2d 626 (8th Cir. 1926), where the Eighth Circuit held that—

. . . good will has no existence *separate and apart* from an established business. With the termination of that business it is ended. While a capital asset, it is not the subject of purchase, sale, or assignment separate from the business itself. It is not an assignable asset distinct in the business itself. It is different in this respect from such intangibles as patents, contracts or franchises which may be sold.

[9] *Houston Chronicle Publishing Co. v. United States,* 481 F.2d 1240, 1253 (5th Cir.) cert. denied, 414 F.2d. 1129 (1974) ("Our view—that amortizability for tax purposes must turn on factual bases—is more in accord with the reality of modern business technology in a day when lists are bartered and sold as discrete vendible assets." *Id.*), *Manhattan Company of Virginia, Inc. v. Commissioner,* 50 T.C 78 (govt's appeal dismissed (*nolle pros,*), acq. 1974-2 C.B. 3; See also cases cited in fn. 12, *infra* at p. 7.

that an intangible asset, having an ascertainable value and a limited life, cannot be depreciated because it is inextricably interwoven with the general goodwill of the business.

When the Third Circuit relied upon *Houston Chronicle Publishing Co. v. United States, supra,* (App. at 16a), it erroneously overexaggerated the import of the "separate and distinct" language. Viewed in the context of the holdings in *Red Wing Malting, supra,* and *Miller, supra,* all that the "separate and distinct" language recognizes is that "goodwill" is not depreciable, but that an intangible asset, for which a taxpayer can demonstrate an ascertainable value and a limited life, is depreciable.

This is exactly what the Fifth Circuit held in *Houston Chronicle.* When that court referred to the acquired Houston Press subscription list as having "an ascertainable value separate and distinct from goodwill" it was referring to "goodwill" in the way that term is used in Treasury Regulation § 1.167(a)-3 (depreciable intangible assets are separate and distinct from non-depreciable (residual) goodwill).

This conclusion is compelled by the Fifth Circuit's additional holding in *Houston Chronicle* (481 F.2d at 1253):

> We reject, however, the establishment of a *per se* rule and a monolithic "mass asset" theory that would amalgamate all subscription lists with goodwill.

In light of this holding, the Third Circuit's reliance upon *Houston Chronicle* for the "separate and distinct" test was misplaced. Houston Chronicle was able to carry its burden of proof that it had acquired an amortizable intangible asset, having an ascertainable value and a limited and determinable useful life. *Id.* Similar proof was introduced by petitioner and found by the District Court in this case. (App. at 33a, *et seq.*)

Though respondent may argue that *Houston Chronicle* should be limited to the circumstance where only an amortizable intangible asset and not an ongoing business and its attendant intangible

assets are acquired, such is incorrect. First, the very fact that such intangible assets as customer lists can be freely traded in the market confirms that these assets have a determinable fair mark et value.[10] Second, even in its own practices, respondent has acquiesced[11] not only in *Houston Chronicle* and another single asset transfer case, *Manhattan Company of Virginia, Inc. v. Commissioner,* 50 T.C. 78 (1968), government's appeal dismissed (nolle pros.), acq. 1974-2 C.B. 3, but also in cases where the depreciable intangible asset was only a part of the business transferred and the assets transferred also included goodwill.[12] Respondent's acquiescences are inconsistent with its contention that the decision in *Houston Chronicle* and *Manhattan Company,* and its own Rev. Rul. 74-456, 1974-2 C.B. 65, only permit depreciation of an intangible asset when it is transferred separate from goodwill.[13] Finally, in *Laird, supra,* the Fifth Circuit extended its *Houston Chronicle* holding to the acquisition of a business having a number of intangible assets: "(t)hat the assets contribute value to one another does not prevent their severability for tax purposes." *Laird,* 556 F.2d at 1234.

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[10] See footnote 9, *supra*; See also Treas. Regs. 20.2031-1(b) (definiton of fair market value); and *United States v. Cartwright,* 411 U.S. 546, 551 (1973).

[11] 1974-2 C.B. 1: "Acquiescence in a decision means acceptance by the Service of the conclusion reached . . . (but) not necessarily . . . acceptance and approval of any or all of the reasons assigned by the Court for its conclusion."

[12] *Los Angeles Central Animal Hospital v. Commissioner,* 68 T.C. 269, 273-274 (1977), acq. 1978-2 C.B. 2; *Computing & Software, Inc. v. Commissioner,* 64 T.C. 223, 235 (1975) acq. 1976-2 C.B. 1; *First Pennsylvania Banking & Trust Co. v. Commissioner,* 56 T.C. 677 (1971) acq. 1972-1 C.B. 2.

[13] Respondent's acquiescences are seemingly on a par with its issuance of Private Letter Rulings. While neither is precedential, *per se,* both are examples of respondent's practices in considering such transactions. *Rowan Cos. v. United States,* 452 U.S. 247, 261, fn. 17 (1981).

II

THE THIRD CIRCUIT'S PHALANX OF CASES ARE MERELY YESTERDAY'S WARRIORS

In its opinion the Third Circuit refers to a "phalanx of cases" that have considered the definition and application of the term goodwill in the context of § 1.167(a)-3 . . . " (App. at 23a-25a.) Though these cases are noteworthy for their attempts to define "goodwill," the Third Circuit erroneously concluded that they also support respondent's position in this case. Merely because a court has defined goodwill in a broad or narrow sense does not mean that the court has also concluded that no "separate and distinct" intangible assets can be found in the amalgamated goodwill acquired.[14] Even more importantly, the cases relied upon by the Third Circuit are *not* the most recent pronouncements from the various circuits on this issue.[15]

III

THE DISTRICT COURT'S "GALAXY OF CUSTOMERS" DESCRIPTION PROVIDES A BRIGHT LINE TEST TO DISTINGUISH BETWEEN A DEPRECIABLE INTANGIBLE ASSET AND NONDEPRECIABLE GOODWILL

The District Court found that petitioner presented substantial uncontroverted proof about its subscribers and their past subscription practices. The court held that it was necessary to (App. at 32a-33a):

> distinguish between a galaxy of customers who may or may not return, whose frequency is unknown, and whose quantity and future purchases cannot be predicted, against subscribers who can be predicted to purchase the same item, for the same price on a daily basis.

In so finding, the District Court provided the Court, the respondent and taxpayers with a "bright line" test to distinguish depre-

[14] See *e.g. Commissioner v. Seaboard Finance Co.; Computing & Software, Inc.; Los Angeles Central Animal Hospital, supra.*

[15] See footnote 1, *supra.*

ciable, customer-based intangible assets from residual non-depreciable goodwill. Most publishers know their subscribers' history and can satisfy the two-pronged test set forth in Treas. Reg. 1.167(a)-(3). Those customers who select a newspaper or a magazine from a newsstand and pay cash are properly part of the "galaxy of customers" and a publication's residual goodwill. So too are the cash-only customers of a fast food restaurant or other similar enterprise—they show up at the counter one day, but no one knows whether they will return tomorrow. The behavior of petitioner's subscribers—and the amicus' subscribers—is statistically predictable and capable of satisfying Treas. Reg. 1.167(a)-(3).

CONCLUSION

The decision of the Third Circuit misperceives and disrupts the clear and unanimous decisions of the various circuits. The question of whether intangible assets, acquired individually or in the acquisition of a business, are depreciable is a question of fact to be determined based upon historical evidence. The Third Circuit's decision is at odds with the precedent in a number of circuits, is wrong and as a matter of law and unfairly reallocates the economic bases underlying many recent transactions. The Court should grant the petition and reverse the decision of the Third Circuit.

Respectfully submitted,

JAMES L. MALONE III
GEORGE W. BENSON
MCDERMOTT, WILL & EMERY
227 W. Monroe St.
Chicago, IL 60606
312-372-2000